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UNITED STATES GENERAL ACCOUNTING OFFICE
REGIONAL OFFICE
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SAN FRANCISCO, CALIFORNIA 94102



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IN REPLY REFER TO:

26337

October 9, 1970

Mr. Ben A. Burk
Regional Commissioner of Customs
Federal Building and Court House
450 Golden Gate Avenue
Box 36117
San Francisco, California 94102

Dear Mr. Burk:

We have examined into the Bureau of Customs procedures and controls over merchandise entered in the San Francisco Foreign Trade Zone and bonded warehouses. Our survey was performed primarily at the San Francisco District Office and at the Foreign Trade Zone.

On the basis of our survey, we found the San Francisco District Office could strengthen its management controls over merchandise imported into the Foreign Trade Zones (FTZ) and class 8 warehouses. Our findings were discussed with Regional and District officials who advised that appropriate corrective action would be taken. These points are summarized below for your information and such further action as you may consider necessary. Although our survey was limited to the San Francisco District, the weaknesses found at the FTZ and bonded warehouse were similar and may also apply to controls at other Customs Districts within your Region.

Need to improve physical and documentary control over zone and warehouse merchandise

Our survey showed that physical security controls at the FTZ and class 8 warehouse were not in accordance with applicable laws and/or regulations, and that inventory controls, particularly the "master lot" procedure at the FTZ, were not adequate to maintain control over merchandise.

FTZ regulations require zone facilities be sufficient to prevent unauthorized entry by persons, conveyances, and merchandise. We observed, however, that persons and merchandise are allowed to pass freely in and out of the zone facilities without notification to or inspection by Bureau of Customs personnel.

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At one zone location we noted that elevators used for transporting merchandise from the zone were not secured during periods when the location was not under Customs surveillance. Also, at two zone locations the trade zone operators have access to Customs inspectors' offices, and at one of these zones the operator has access to Bureau of Customs records.

Bureau of Customs procedures require that inventories of FTZ merchandise be taken at least once each year, and that adequate records be maintained to identify the merchandise inventoried and the results of such examinations. At the one sub-zone location, no inventory has been taken since the location was established in 1963. We were informed that, at another location of the FTZ, a spot check of the merchandise was taken in 1969; however, the records were lost and no subsequent checks have been made. District officials said, at the time of our review, that they plan to take inventories at these two locations in the near future. We found also that, although the Customs manual provides that inventory checks of bonded warehouses will be made on an annual basis, no inventory checks were made during 1969 at the warehouse reviewed. Also, our review showed that there was no record of an inventory check at the bonded warehouse since October 1966.

Our review showed also that the District office was relying on the zone operators' inventory records without audit or verification for merchandise handled in "master lots" by zone operators. A master lot is composed of several individual entries (lots) of similar merchandise entered into the zone. The District office does not, however, maintain identity of the individual lots and when merchandise is withdrawn no reconciliation is made by Customs to the original zone lot entry. We were advised that Customs had not maintained separate inventory records because it would be a duplication of the records maintained by the zone operator. In our opinion, the master lot records do not provide adequate control over merchandise imported into foreign trade zones.

We found also that, at one zone location, liquor was re-packed without Customs supervision, to consolidate cases which had missing and broken bottles. According to Customs officials,

the zone operators are held accountable for duties and taxes on shortages of bottles but not on broken bottles for which breakage could be evidenced by bottlenecks. We observed numerous boxes containing bottlenecks, stored in various locations throughout the warehouse, which were not under Customs supervision. We found that no controls had been established to prevent the reuse of bottlenecks to cover inventory shortages.

In discussing these points with Region and District office officials, we were advised that action would be taken to review the security precautions at the zone facilities, and that inventories of zone and warehouse merchandise would be taken. We were advised that action would be taken to review inventory controls over master lots and that controls would be instituted for the bottlenecks.

Need to determine the current value of imported merchandise manipulated in the subzone

In 1963, a subzone was established in San Francisco for the exclusive use of a clothing design and manufacturing company. The company imports bolts of woven woolen fabrics and cuts the fabrics into pieces suitable for manufacture of women's garments. The rate of duty at the time of the establishment of the zone, and still in effect at the time of our review, was 38 percent ad valorem plus 37.5 cents per pound on bolts of woven fabric, but only 21 percent ad valorem plus 25 cents per pound on finished or semifinished garments.

A report on subzone operations issued by the Regional Office in September 1968 recommended that the District Director initiate a study to determine the amounts of foreign costs and expenses added to garments imported through the subzone. These costs are used to calculate the amount of duty to be assessed on manipulated merchandise. The report pointed out that the foreign costs and expenses had remained unchanged since the establishment of the subzone in 1963 and that it is probable there has been a substantial change in these costs.

At the completion of our review, the District office had not determined a new value for the fabric. In discussing this matter with Regional and District officials, we were informed that the

Mr. Ben A. Burk

- 4 -

final liquidation of duty payments by the subzone operator are being held up awaiting information on the foreign costs and expenses involved.

We would like to receive your comments on the above matters. We appreciate the cooperation extended to our representatives by you and your staff and were pleased to see the interest displayed by Customs officials in acting to resolve the above matters.

Sincerely yours,

A. M. Clavelli
Regional Manager